IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

No. 559.

GUY T. HELVERING, Commissioner of Internal Revenue,
PETITIONER,

v.

JULIAN PRICE.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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Statement.

The petitioner, the Commissioner of Internal Revenue, has petitioned this Court for writ of certiorari to review the judgment of the Court below upon the grounds:

1. That the judgment of the Court below is in conflict with a decision of the United States Court of Appeals, Second Circuit, known as *Jenkins v. Bitgood*, 101 F. (2d) 217, and with the prior decision of this Court in *Eckert v. Burnet*, 283 U. S. 140;

2. That the judgment of the Court below obliterates the distinction between the cash and accrual bases of accounting.

Question Presented.

The question as presented in the petition for certiorari does not raise the real issue that is in this case, hence we beg leave to restate the issue as it was before the Court below, and as we believe it to be here.

The issue is not whether under the facts in the case what was done *constituted payment* of certain *notes*. The *real issue* that was before the Court below and is now presented to this Court is this:

The Board of Tax Appeals *found as a fact* that the taxpayer by *express agreement* with the North Carolina Bank & Trust Company *paid and discharged* his obligations under a *guaranty* of certain assets of another bank, and that the North Carolina Bank specifically accepted taxpayer's note and securities in *final settlement* and compromise of all further liability *under said guaranty*.

Is this Court to review this *finding of fact* (not a conclusion of law) of the Board of Tax Appeals that the taxpayer paid and discharged his obligations *under the guaranty*, merely because the *payment agreed upon* by the parties and *accepted by the Bank* was a payment made *in property* instead of in cash?

That is the real issue in this case.

Statement of the Facts.

The facts in the case were correctly found by the Board of Tax Appeals and have never been questioned. (R. 12-17.) The facts may be summarized as follows:

1. Taxpayer in September, 1929, upon a merger of certain banks, entered into a contract with North Carolina Bank & Trust Company, whereby he jointly with three other stockholders of the merged bank, agreed to guarantee certain assets of the merged bank, known as the Class A assets. In the event the guarantors were required to pay anything on account of losses in the Class A assets, they were entitled to reimbursement therefor out of certain assets known as Class B assets.

2. In June, 1931, the North Carolina Bank advised the guarantors that their guaranty was not in such shape that the Bank could use it, and accordingly requested the guarantors to put their guaranty into a bankable form so it could be used by the Bank to obtain credit. Taxpayer agreed, and accordingly executed and delivered to the Bank a note for $125,000 and endorsed the note of C. W. Gold, another guarantor, for a like amount, and assigned certain securities to the Bank as security for the payment of his guaranty. In consideration of his putting his guaranty into such bankable form the Bank agreed that the taxpayers' ultimate liability under his guaranty should not exceed $250,000.

3. "At the end of 1931 the *guaranty agreement was still in force and effect.* The 'B' assets were still in the hands of the North Carolina Bank as trustee and were still in the process of collection. No demand had ever been made upon the petitioner (taxpayer) for the payment of any part of his obligation under the guaranty. While it was known that there would be some loss to the guarantors, it was not definitely known throughout 1931 what the loss would be, and the guarantors had every reason to believe that there would be a substantial reimbursement from the Class B

assets of any losses." (Findings of Fact, Board of Tax Appeals) (R. 14-15.)

4. In the early part of 1932 financial conditions in Greensboro took a turn for the worse, and collections on the A and B assets declined to a point where the Bank realized that it would have to collect upon the *guaranty*. Accordingly in March, 1932 the North Carolina Bank called upon taxpayer to make a *final settlement* of his obligations under the *guaranty*. (R. 15.)

5. The taxpayer thereupon offered to make a final settlement of his obligations under the guaranty by giving the Bank his note for $250,000, and assigning to the Bank certain securities which the Bank held. The Bank *accepted the taxpayer's offer*, and upon receipt of the taxpayer's note and the assignment of the securities which it already held, considered that the *guaranty obligations were fully discharged*, and accordingly delivered to taxpayer the two notes which had been executed under the guaranty agreement and marked them paid. Both the taxpayer and the Bank considered this to be *final payment* and *settlement* of taxpayer's *obligations under the guaranty*. (R. 15.)

6. The taxpayer claimed a loss on the transaction in his return for 1932 in the amount of $125,000, being his own half of the guaranty for which he had no possibility of reimbursement. He did not claim a loss on Gold's half of the guaranty in 1932 because he still had a claim against Gold's Estate for reimbursement. In his return for 1933 taxpayer claimed a loss for the remaining half, representing Mr. Gold's part of the guaranty, when it was ascertained that Gold's estate was insolvent in 1933. (R. 16.)

The Commissioner allowed the loss claimed for 1933, when it first appeared that Gold's Estate was insolvent and that taxpayer would receive no reimbursement for the loss sustained on that part of the guaranty. He disallowed the loss claimed for 1932 upon the ground that the taxpayer had not paid cash in that year. But the loss for both years arose out of precisely the same transaction. (R. 35.)

Summary of Argument.

Point 1. The decision of the Court below is not in conflict with *Eckert v. Burnet*, or *Jenkins v. Bitgood*, or with any other case cited by the Commissioner.

The decision here is in harmony with the clearly expressed opinion of this Court as to the correct construction of *Eckert v. Burnet* which is found in *Burnet v. Logan*, 283 U. S. 404.

The decision here is in harmony with the decision of the Circuit Court of Appeals for the Eighth Circuit in *Crain, Exec., et al. v. Commissioner*, 75 F. (2d) 962, a decision published by the Commissioner as a Treasury Decision in Cumulative Bulletin XIV-2, 281.

It is in harmony with *Jenkins v. Smith*, 21 F. Supp. 433, affirmed (C. C. A. 2) in 99 F. (2d) 827.

Point 2. The decision of the Court below that the payment and discharge of a legal obligation is not required to be *in cash*, but may consist of the giving and acceptance of *other property* agreed upon by the parties—has been recognized by this Court for over one hundred years. See *Lyman v. Bank*, 53 U. S. 225; *Segrist v. Crabtree*, 131 U. S. 287; *Case Manufacturing Co. v. Soxman*, 138 U. S. 431.

This principle has been followed by the Federal courts and by the Board of Tax Appeals in many tax cases, both as to items of income and as to items of deductions. *Schlemmer v. United States*, 94 F. (2d) 77, and cases there cited.

This Court has held specifically that the giving and acceptance of fully secured promissory notes may *constitute payment* of a legal obligation, and that such notes are the *equivalent of cash* for income tax purposes. *Pinellas Ice and Cold Storage Co. v. Commissioner*, 287 U. S. 462, 77 L. ed. 428.

Point 3. The decision of the Court below has nothing whatever to do with obliterating the distinction between the cash basis and the accrual basis of accounting.

ARGUMENT.

Point 1.

The decision of the Court below is not in conflict with Eckert v. Burnet, or Jenkins v. Bitgood, or with any other case cited by the Commissioner.

There are at least six respects in which *Eckert v. Burnet* is distinguishable:

1. In the first place, the *Eckert* case involved the question of a *bad debt*. In the instant case the taxpayer claims the deduction as a *loss* arising from a contract of guaranty. The two types of deductions are provided for under different provisions of the revenue act, and the rules applicable to the two types are by no means the same. A bad debt is deductible in the year it is ascertained by the taxpayer to be worthless. On

the other hand a loss is deductible in the year it is sustained or realized, due to the happening of definite or identifiable events.

The *Eckert* case has been expressly distinguished upon this ground in several cases, the leading case being *Burns Mfg. Co. v. Commissioner*, 59 F. (2d) 504, where the Circuit Court of Appeals, Ninth Circuit, analyzed the *Eckert* case at length and then said, p. 507:

> "In the *Eckert case* the Supreme Court considered merely the effect of section 214(a) 7, 26 U. S. C. A. Sec. 955 (a) (7), which provides for deduction for '*debts ascertained to be worthless* and charged off within the taxable year.' The amount here under consideration was a '*loss*' and *not a 'bad debt'* and consequently the *decision in the Eckert case is not controlling.*" (Italics ours.)

Indeed, the headnote and syllabus of *Eckert v. Burnet* exemplifies the point actually decided in that case too plainly for misunderstanding. It reads as follows:

> "One making his income tax returns on the cash basis, who has given his own note in exchange for worthless notes on which he was an endorser, cannot deduct from the gross income of the year in which he so gave his own note the amount thereof, *as a debt* 'ascertained to be worthless and charged off within the taxable year,' under the Revenue Act of 1926, c. 27, sec. 214(a)(7), etc."

That was the basis of this Court's decision in *Eckert v. Burnet*. No question as to a *loss* was decided in *Eckert v. Burnet*, and Sec. 214(5) (the provision as to losses) was not even mentioned.

There is certain language in the latter part of the *Eckert v. Burnet* opinion which uses the word "loss" somewhat ambiguously, but it is obvious that such language did not apply to the *loss provisions* of the revenue act of 1926 (Sec. 214(5)). It follows that such language of this Court would be *dictum* if it were to be applied to a *claim for a loss—i. e.*, a claim arising under a section of the revenue act which was not before this Court in *Eckert v. Burnet*.

Precisely this construction of *Eckert v. Burnet* is made by Judge Learned Hand in *Shiman v. Commissioner*, 60 F. (2d) 65, where it is said:

> "We can see no ground therefore for question except some of the language used in Eckert v. Burnet, 283 U. S. 140, 51 S. Ct. 373, 75 L. Ed. 911, taken from our opinion in 42 F. (2d) 158. That was quite another situation. Eckert, the taxpayer, had been an accommodation endorser for a corporation which became insolvent. When called upon to *pay* he gave his note *instead*, not payable within the year. The court refused to allow the deduction, because Eckert was keeping his books on a cash basis, but it intimated that when he paid he might succeed; until then he had done no more than change the form of the obligation. Yet if it were enough to defeat him that the debt was 'worthless when acquired,' *the same objection ought to be good after he had paid; contrary to what was suggested. We cannot therefore think that the language so thrown out was intended as an authoritative statement by which we must be bound.*" (Italics ours.)

2. In the second place, there was *no agreement* whatever between Eckert and the bank that Eckert's note should be accepted by the bank as a *final payment or discharge*

of the corporation's note. As Judge Hand put it: "When called upon to *pay* he gave his note *instead.*"

In the instant case it was *expressly* agreed between Mr. Price and the North Carolina Bank that the note and securities given by Mr. Price should *pay and discharge* any further obligations of Mr. Price under his guaranty. (R. 15 and 19.)

3. In the third place, the issue in the two cases was entirely different. The issue in the *Eckert* case was whether upon all the evidence in that case the Board could decide *as a conclusion of law* that what was done *constituted payment*, or not.

But in the instant case the Commissioner conceded and the Board found *as a fact* upon the testimony that Mr. Price's obligations under the guaranty were *paid and discharged* and that the Bank accepted Price's note and security in a *final settlement and compromise* of all further liability under the guaranty. (R. 15, 19; Deposition Price, pp. 23, 24, 37.)

The question as to *what constitutes payment* was never an issue in this case.

4. In the fourth place, in the *Eckert* case there was no transfer or assignment of securities or other property by Eckert to the bank.

In the instant case Mr. Price assigned securities to the Bank admitted by the Commissioner to be worth in excess of $250,000, and which Price could never get back without substituting other property of equal value therefor.

5. In the fifth place, in the *Eckert* case there was no other property (corresponding to the Class B. assets in the instant case) to which Eckert could look for reimbursement, and which also became worthless during the taxable year as was the case here. ((R. 13-15.)

6. And, finally, in the *Eckert* case the claim for a *bad debt* in question arose out of Eckert's endorsement of a *note*.

In the instant case, however, the *loss* claimed by Mr. Price arose out of his independent *contract of guaranty* of certain real estate and other Class A assets of a closed bank, liability for which became fixed and determined for the first time in 1932 when the losses occurred in those assets.

In short, *Eckert v. Burnet* is not in conflict with the instant case at all—either in principle or in fact.

The Court below did *not* consider *Eckert v. Burnet* as conflicting. The Court did discuss the *Eckert* case, but carefully distinguished that case *upon its facts*, and then pointed out that the issue there was entirely different, saying in part:

> "We consider this case (Eckert v. Burnet) as definite authority only for the holding that a loss of the character set forth is not deductible under the '*bad debt*' provision of the statute (Burns Mfg. Co. v. Commissioner, 9 Cir. 59 F. 2d 504, 507), although the language does indeed go further and lay down the proposition that where there is a mere deferring of a loss by the renewing of an obligation, the loss may not be deducted until the obligation is paid, *a proposition which we are not disposed to question*. That it was not intended to prevent by that decision the taking

> of a loss in a case such as this, where the loss is evidenced by a closed transaction, but merely to prevent the taking of a supposed loss which has never been realized, is indicated by the decision in *Burnet v. Logan*, 283 U. S. 404, 413, where the court refers to the Eckert decision as follows: '*Ordinarily*, at least, a taxpayer may not deduct from gross receipts a supposed loss which in fact is represented by his outstanding note. Eckert v. Commissioner of Interual Revenue, *ante*, p. 140. And, conversely, a promise to pay indeterminate sums of money is not necessarily taxable income.' "Generally speaking, the income tax law is concerned only with realized losses, as with realized gains." ' "

In fine, the decision of the Court below is based wholly *upon the facts* in the instant case. The Court rests its decision squarely upon the agreement between Mr. Price and the North Carolina Bank by which Price's obligation (as well as Gold's) under the guaranty was finally compromised and settled. The Court below called this agreement the "crucial matter" of the case and quoted in full the finding of the Board of Tax Appeals on that point as its *firmum decisis*. (R. 34.)

* * * * *

As to the case of *Jenkins v. Bitgood* less need be said. The facts are utterly different from start to finish from those in the instant case, and the issue in neither the District Court nor in the Circuit Court of Appeals was the same as the issue is here.

In *Jenkins v. Bitgood* taxpayer was director of a bank which owned certain bonds that had depreciated in value. to make up this depreciation the directors in 1931 agreed

to purchase from the bank these bonds at their original cost price to the bank. Jenkins therefore purchased bonds having a face value of $25,000 (but a market value of only $5,550) and gave his promissory note to the bank which delivered to him the bonds.

In 1932 the bank failed and its stock became worthless. Jenkins claimed a loss *on the bonds* so purchased by him of $19,450, being the difference between the amount he had paid for them, to wit, $25,000, and the market value of such bonds.

The District Court held that the 1931 transaction was a purchase of the bonds from the bank by the taxpayer, that "the $25,000 was undoubtedly an investment in bonds", and that, since the bonds had not been disposed of during the taxable year, there was "nothing upon which to predicate a deductible loss in 1932." (21 F. Supp., p. 250.) The decision of the District Judge upon rehearing was that "the substance of the transaction was a purchase and sale of securities", to wit, bonds, and the former opinion was reaffirmed (22 F. Supp. 16).

Jenkins appealed to the Circuit Court of Appeals and contended that the purchase of the bonds in 1931 in effect represented an additional cost of his stock in the bank. The Commissioner did not contest that argument, but denied the loss. The Circuit Court of Appeals therefore *assumed* that it was a contribution to capital, and then—after admitting that no authority on the question had been found—proceeded to hold that a taxpayer *can not make an expenditure increasing the cost of his stock in a business enterprise by the giving of a note.* The Court went further and said that the taxpayer's additional cost will not be "made" until the taxpayer pays the note which he gave in 1931.

Aside from the doubtfulness of the Circuit Court's decision that a taxpayer can not increase the cost of an investment in stock by the giving of a note, it seems perfectly clear that the issue in *Jenkins v. Bitgood* involved a wholly different question of law than the issue in the instant case. For example:

1. *Jenkins v. Bitgood* was decided by the District Court on the issue of the taxpayer's *purchase of bonds* which had not been disposed of during the taxable year, and hence no loss was deductible.

On the other hand, the case was decided by the Circuit Court of Appeals upon the issue of whether or not the 1931 transaction amounted to a contribution to capital. Neither of those two issues of law is involved in this case.

2. In the second place, the opinion of the Circuit Court is devoted to the consideration of an issue which was not contested by the Commissioner, *i. e.*, that the 1931 transaction was a contribution to capital. That, however, was not the issue upon which the case was decided by the lower court, and hence the principal part of the Circuit Court of Appeals' opinion was moot, being based upon a conceded issue.

3. In the third place, the statement of the Circuit Court that Jenkins could "make" no investment in the bonds which he purchased because he paid for them by giving a note instead of cash, is patently erroneous. The effect of such a decision would lead to absurd results. If a taxpayer can not deduct a loss on worthless stock or bonds merely because he has not paid *all the purchase price in cash*, then the whole business world will be revolutionized. Every stockholder in the nation will hold stock at his peril unless he pays for it in full and in cash. If a man's automobile is destroyed

by fire or collision, he can not claim the loss merely because his purchase money note is still in the hands of a finance company.

* * * * *

The case of *Ferris v. Commissioner* referred to in the petition for writ of certiorari, was a decision of the Board of Tax Appeals which was affirmed *per curiam* without opinion by the Circuit Court of Appeals, Second Circuit: We do not know the reasons why the Circuit Court affirmed the Board. The opinion referred to *Eckert v. Burnet*, but the facts in the *Ferris* case were quite different from those in the *Eckert* case.

The *Ferris* case involved the giving of a check by the taxpayer; the *Eckert* case arose out of a note given in substitution for another note. In the *Eckert* case there was no agreement whatever between the parties that what was done there should constitute payment and discharge of the prior note; in the *Ferris* case there was a presumptive payment arising from the giving and acceptance of the check. In the *Eckert* case there was no negotiation for a loan of funds, nor was there any actual borrowing of money by Eckert; in the *Ferris* case Mr. Ferris negotiated with the bank for a loan of funds and obtained sufficient funds to pay the debt.

More than that, however, it is difficult to see any conflict between the *Ferris* case and *Eckert v. Burnet* for the obvious reason that the issue in *Eckert v. Burnet* was one of a *bad debt*, while the issue in the *Ferris* case was one of a *loss*. It seems quite doubtful, therefore, whether *Eckert v. Burnet* was any more authority for the decision in *Ferris* case, than it is authority for this case.

* * * * *

The decision of the Court below is entirely in line with several decisions of long standing in which the Commissioner has long acquiesced, and which in fact the Commissioner has cited and relied upon in other tax cases.

One of the leading cases is *Crain, et al. v. Commissioner*, 75 F. (2d) 962, published by the Commissioner as a Treasury Decision in C. B. XIV—2, p. 281. The facts in that case are quite analogous and deserve a brief review. In the *Crain* case the taxpayer with one Wesson became liable upon the obligations of National Car Advertising Company, which they jointly assumed. In 1913 it was evident that there would be a loss, but the amount of the loss was still uncertain. In 1916 it became definitely known what the amount of the loss was, and that taxpayer and Wesson were jointly and severally liable for the full amount of the loss. By a general agreement between the parties it was agreed that Wesson should take care of the corporation's obligations, and that taxpayer would give Wesson his note for one-half thereof. Taxpayer claimed the loss in a later year. Said the Court:

> "But in the year 1916, the amount of *loss became definitely certain*, and the whole of it was actually paid by Wesson. Since the taxpayer did not himself have on hand enough cash to pay his half, he agreed with Wesson that the latter should *advance all of the money in payment of the loss*, and the *taxpayer would make to Wesson a note for the taxpayer's half of such loss.*
>
> "*In fair effect, what the taxpayer did in 1916 was to borrow $40,000* in money with which to pay the loss now, here in dispute, as to the date of its accrual for taxing purposes. It seems clear, from the facts here and the ruled cases, that the loss occurred in 1916. Avery v. Commissioner (C. C. A.), 22 F. (2d) 6, 55 A. L. R. 1277; Darling v. Commissioner (C. C. A.), 49

F. (2d) 111. Did the giving of the note to Wesson have the effect to lawfully postpone deduction of the loss from income till the year in which the note was paid?

"The taxpayer contends that it did, and, so contending, relies largely on the case of Eckert v. Commissioner, 283 U. S. 140, 51 S. Ct. 373, 374, 75 L. Ed. 911, as decisive in his favor. * * *" (Italics ours.)

The Court in this opinion distinguishes the *Crain* case from the *Eckert* case and holds that the deductible loss occurred in 1916. The Court then says:

"Moreover, counsel agree, and the decisions of the Board of Tax Appeals sustain their agreement, that the fact that *a loss is paid in borrowed money does not have the effect to change the date at which the loss was sustained from the year of the loss to the year in which the borrowed money was repaid.*" (Italics ours.)

* * * * *

"To the same effect are the cases of Weis v. Commissioner, 13 B. T. A. 1284; Crawford v. Commissioner, 11 B. T. A. 1299; and Perry v. Commissioner, 28 B. T. A. 497."

Also in line with the decision here is the case of *Jenkins, et al. v. Smith*, 21 F. Supp. 433, affirmed 99 F. (2d) 827. In that case the taxpayer in order to protect his stock in a bank, made a guaranty agreement in 1932 jointly with other directors and deposited certain collateral. In 1933 the bank ceased doing business and called on the guarantors for payment under their guaranty. Taxpayer thereupon made arrangements with the bank to borrow upon his note the same amount of money for which he was liable to the bank, and to apply the same to the payment of his

guaranty obligations. This was done and accordingly taxpayer claimed a loss in his return for 1933. Said the Court:

"The deduction was proper and plaintiffs must prevail if, under all the circumstances, the *obligation on the bond was paid.* The defendant urges, however, that there was no payment in fact, but only in form, since the decedent remained obligated to the First National Bank and Trust Company for the same amount, evidenced by a new note. He parted with no cash in 1933, but merely borrowed from his payee in order to pay the same payee.

"In my opinion, *the obligation on the bond* was discharged by the acceptance by the First National of the check as payment. *Where or how the decedent obtained the money with which to make the check good is immaterial.* The acceptance of the check as payment discharged the obligation, even though it created an overdraft. A new cause of action arose upon the check. The First National could no longer have sued the decedent on the bond. The bank knew of the overdraft, but was satisfied to take its chances on the new obligation. *The bond transaction was closed.*

"The credit to the decedent's account, made on the same day, was the result of a new transaction, initiated by a promissory note to the bank secured by new collateral. It was in no sense an extension of time for payment of the old debt. It was *a new contract of a substantially different nature.*" (Italics ours.)

Point 2.

The decision of the Court below that the payment and discharge of a legal obligation may be made by the giving and acceptance of property other than cash, is in accord with the decisions of this Court for over one hundred years.

Lyman v. Bank, 53 U. S. 225; *Segrist v. Crabtree*, 131 U. S. 287; *Case Manufacturing Co. v. Soxman*, 138 U. S. 431.

That principle of law has been recognized by the Federal courts in many recent tax cases, as applied to both questions of *income* and questions of *deductions* from income. *Schlemmer v. United States*, 94 F. (2d) 77 (2d. Cir.); *George J. Mellinger v. United States* (Ct. Cl.) 21 F. Supp. 964; *Humphrey v. Commissioner*, 91 F. (2d) 155 (9th Cir.); *Jenkins v. Smith*, 21 F. S. 433, aff'd 99 F. (2d) 827 (2d Cir.); *Bedell v. Commissioner*, 30 F. (2d) 622 (2d Cir.).

This Court has recognized in tax cases that an obligation may be paid and discharged for income tax purposes by the giving and acceptance of fully secured notes, and that such notes shall be treated as the "equivalent of cash". *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462.

The decision of the Court below that the payment of a legal obligation need not be made in cash for income tax purposes has been recognized by the Commissioner's own regulations for over twenty years. Ever since Regulations 45, promulgated under the Revenue Act of 1918, and continuing through successive Regulations promulgated under the revenue acts thereafter, the Commissioner has ruled as follows:

"Items of *income* and of *expenditures*, which as gross income and *deductions* are elements in the computation of net income *need not be in the form of cash.* It is sufficient that such items, if otherwise properly included in computation, *can be valued in terms of money.*" (Art. 321, *Regulations 77* and *74*; Art. 22, *Regulations 69, 65, 62* and *45.*)

The leading text writers on income taxation have always recognized this principle. In *Holmes "Federal Taxes,"* Sec. 471, the rule is stated as follows:

"It is not necessary that an amount claimed as a deduction be paid out in cash. Just as income may be received in kind or in the equivalent of cash, so *deductions may be represented by payments* in some form other than actual cash."

In *Paul & Mertens "Law of Federal Income Taxation"*, we find this:

"* * * the term 'cash method' is a misnomer. * * * It does not mean that *only* cash receipts are taxable, any more than it means that *all* cash receipts are taxable. The thought is rather that *both taxable income and items of expenditure need not be in the form of cash.*" (Sec. 10.01) citing 46 *Harvard Law Review* 933.

"Many of the decisions turn on the question of *security;* they regard as the equivalent of cash obligations which are in some way—by lien, mortgage or otherwise—*secured.* Often this question is valid because relevant to the point of *convertibility into cash.* * * * The real question is whether *cash can be realized;* has the equivalent of cash been received." (Sec. 10.05) Citing *Bedell v. Commissioner*, 30 F. (2d) 622; *S. L. Meyer*, 23 B. T. A. 1200.

"Bonds, notes and contracts for the payment of money and other property are the equivalent of cash if, received on an income-producing transaction, to the extent of their fair market value * * *" (Sec. 10.16). Citing *Brinkerhoff-Faris Trust Co.*, 14 B. T. A. 801.

"This whole subject of the extent to which notes should be treated as the equivalent of cash is still in a state of uncertainty. The *general rule is clear that notes may be treated as the equivalent of cash;* * *" (Sec. 10.16). Citing *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 462.

Roswell Magill, former Undersecretary of the Treasury, in the *Harvard Law Review*, Vol. 46, p. 936, states the principle as follows:

"A concession is necessary, at the outset, because the bulk of claims are not actually liquidated in cash; salaries, dividends, rent, interest, are commonly paid by check. * * *Negotiable *notes have been treated as cash to the extent of their fair market value,* but a non-negotiable note has been regarded as giving rise to income only as collected." Citing *Lyle v. Olson*, 24 B. T. A. 702; *A. W. Wolfson*, 1 B. T. A. 538; *Potter Farms, Inc.*, 6 B. T. A. 110; *C. W. Slater*, 5 B. T. A. 804; *Mainard E. Crosby*, 14 B. T. A. 980.

Payment is the test of whether a given item constitutes either income or a deduction to a taxpayer. As stated by *Paul & Mertens*, Sec. 11.21:

"*The corollary of the rule stated in regard to income is true with respect to deductions.* Taxpayers on a cash basis may not take advantage of a liability to pay; they have no right to a deduction until they make payment."

"The *rule* that deductibility in the case of taxpayers on a cash basis *depends on payment* introduces the question of *what constitutes payment.*".

The decision of the Court below is based squarely on the facts in this case: to wit—(1) that by express agreement with the North Carolina Bank taxpayer paid and discharged his obligations under the guaranty and that the Bank accepted taxpayer's note and security in final settlement and compromise of all further liability thereunder; and (2) that the taxpayer's note was fully secured and was the equivalent of cash; and (3) that the taxpayer thereby parted with money or money's worth, which is all the statute requires.

Point 3.

The decision of the Court below has nothing whatever to do with obliterating the distinction between the cash basis and the accrual basis of accounting.

As already pointed out, the decision of the Court below is based entirely upon the peculiar facts in this case. The decision of the Court accepts *as a fact* the finding of the Board of Tax Appeals that the taxpayer's note was fully secured by the irrevocable assignment of securities to the Bank, that the parties settled and compromised taxpayer's obligations under the guaranty, and that the Bank accepted the taxpayer's note and security as a final payment of any further liability thereunder.

To a taxpayer on a cash basis the test of deductibility of an item of loss or expense, as well as the test of inclusion of

an item of income, has always been *payment*. Where payment has been conceded as a fact by the Commissioner and found as a fact by the Board, no issue of law as to *payment* can possibly arise. The very *fact of payment* itself complies with all the requirements of the cash basis—hence we fail to see how the decision below could possibly effect, or change, or modify the principles of taxation which apply to the cash basis of accounting. In short, the taxpayer did all that the cash basis requires to entitle him to the deduction—he paid and discharged his obligations to the Bank under his old guaranty. That is all that the cash basis implies, and that is all the law requires.

We respectfully submit that there is no conflict whatever in principle between this case and the cases cited by the Commissioner, and that the application for the writ of certiorari should be denied.

Respectfully submitted,

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